

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
CITIZENS COMMUNICATIONS COMPANY,)
KAUAI ELECTRIC DIVISION)
and)
KAUAI ISLAND UTILITY CO-OP)
For Approval of the Sale of Certain)
Assets of Citizens Communications)
Company, Kauai Electric Division)
and Related Matters.)

DOCKET NO. 02-0060

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DECISION AND ORDER NO. 19658

Filed Sept 17, 2002
At 1 o'clock P..M.

Kuo H. Nakagawa
for Chief Clerk of the Commission

ATTEST: A True Copy
LEATRICE G. ASAHI
Clerk, Public Utilities
Commission, State of Hawaii.

Leatrice G. Asahi

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)	
CITIZENS COMMUNICATIONS COMPANY,)	Docket No. 02-0060
KAUAI ELECTRIC DIVISION)	
and)	Decision and Order No.19658
KAUAI ISLAND UTILITY CO-OP)	
For Approval of the Sale of Certain)	
Assets of Citizens Communications)	
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_____)	

DECISION AND ORDER

I. Introduction

On March 15, 2002, CITIZENS COMMUNICATIONS COMPANY, (Citizens) KAUAI ELECTRIC DIVISION and KAUAI ISLAND UTILITY CO-OP (KIUC), collectively called Applicants, filed an application requesting commission approval of: (1) the Amended and Restated Purchase and Sale Agreement dated March 5, 2002 (Amended Agreement); (2) the assignment of Citizens' Kauai Electric Division's (KE) legislatively-granted franchise to KIUC, pursuant to Hawaii Revised Statutes (HRS) § 269-19; (3) the sale of certain of KE's assets to KIUC; and (4) the financing proposed to be obtained by KIUC for the purpose of acquiring KE's assets, pursuant to HRS § 269-17.¹

¹On April 6, 2000, Applicants filed an application in Docket No. 00-0108, requesting commission approval of the sale of KE's assets to KIUC, including KE's franchise to operate as a public utility on the Island of Kauai and other matters related

Applicants served copies of their application on the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS (Consumer Advocate).²

II. Applicants

A. Citizens and KE

Citizens is a publicly traded Delaware corporation, whose corporate offices are in Stamford, Connecticut. It currently has telecommunications, electric and gas operations serving customers in 24 states. However, Citizens decided to concentrate on its telecommunications operations and is in the process of selling its other operations. Its sale of KE is part of the divestiture of its non-telecommunications divisions.

KE, now a division of Citizens, has provided electric service to the Island of Kauai since 1969, when Kauai Electric Company, Limited merged into Citizens.³ KE serves the Island of Kauai, has more than 30,000 customer accounts, and employs 122 personnel. KE's main office is located in Lihue.

to said sale, pursuant to the terms and conditions set forth in that certain Purchase and Sale Agreement dated February 11, 2000 (Original Application). By Decision and Order No. 17970, filed on August 14, 2000, in Docket No. 00-0108, the commission denied the Original Application.

²Pursuant to HRS § 269-51 and Hawaii Administrative Rules § 6-61-62, the Consumer Advocate is an ex officio party to this proceeding. The Consumer Advocate is responsible for representing, protecting and advancing the interests of all consumers in this matter.

³The commission approved the merger of Kauai Electric Company, Limited into Citizens in Decision and Order No. 3160, filed on March 13, 1973, in Docket No. 2003.

Transmission and distribution service centers are located in Kapaa and Eleele. KE's production facilities are located at the Port Allen Generating Station near Eleele. Additionally, KE expects to provide service from the Lihue Energy Service Center sometime in 2002.

B. KIUC

KIUC was formed, pursuant to HRS Chapter 421C, as a non-profit cooperative association for the purpose of acquiring KE. Its principal place of business and postal address is 2970 Haleko Road, Suite 202, Lihue, Hawaii 96766. KIUC is duly incorporated, validly existing, and in good standing under the laws of the State of Hawaii.

III. Procedural Background

As previously mentioned, Applicants filed their application (Application) in the instant docket on March 15, 2002, requesting commission approval of: (1) the Amended Agreement; (2) the assignment of KE's legislatively-granted franchise to KIUC, pursuant to HRS § 269-19; (3) the sale of certain assets of KE to KIUC; and (4) the financing proposed to be obtained by KIUC for the purpose of acquiring KE's assets, pursuant to HRS § 269-17.

On March 19, 2002, pursuant to a Stipulation for Protective Order entered into between the Applicants and the Consumer Advocate, the commission issued Protective Order No. 19257 setting forth the procedures for

dealing with privileged and confidential information that may be requested and/or filed in this docket.

On March 27, 2002, The DEPARTMENT OF THE NAVY (DoN) filed a motion to intervene. By Order No. 19313, filed on April 24, 2002, (Order No. 19313) the commission granted the DoN's motion.⁴

On April 3, 2002, The COUNTY OF KAUAI (County) filed a motion to intervene.⁵ By Order No. 19314, filed on April 24, 2002, (Order No. 19314), the commission granted the County's motion.⁶

On April 9, 2002 and April 18, 2002, respectively, the Consumer Advocate filed its first and second sets of information requests. Applicants filed responses to these requests on April 25, 2002 and May 15, 2002, respectively, which, among other

⁴The DoN is tasked with the maintenance of the Pacific Missile Range Facility at Barking Sands on the Island of Kauai and is one of KE's largest customers.

⁵In addition to the DoN and County, other entities moved to intervene or participate. Specifically, Life of the Land (LoL) filed a motion to intervene on March 27, 2002, which the commission denied by Order No. 19312, filed on April 24, 2002. By Order No. 19349, filed on May 9, 2002, the commission denied LoL's motion for reconsideration filed on May 3, 2002. The Hawaii Renewable Energy Alliance (HREA) filed a motion to intervene on April 4, 2002. The commission denied HREA's motion in Order No. 19315, filed on April 24, 2002. Concerned Residential Customers (CRC), an informal association of individuals, filed a motion to participate and a motion for enlargement of time on April 17, 2002. The commission denied CRC's motion for enlargement of time and dismissed CRC's motion to participate as being untimely in Order No. 19324, filed on April 24, 2002.

⁶The County is a large purchaser of electric service and is responsible for certain health, safety and welfare interests of the residents of Kauai.

things, updated the responses to approximately 295 information requests previously submitted by the Consumer Advocate, the DoN, and the County in Docket No. 00-0108 to address and reflect the changes between the Original Application and the Application.

On May 7, 2002, the parties held an informal meeting, as required by Order Nos. 19313 and 19314, to formulate the issues and procedural schedule that would govern the proceedings in the instant docket, to be set forth in a stipulated order to be agreed upon by the parties.

On May 15, 2002, the parties submitted for the commission's review and approval, a stipulated procedural order, incorporating the issues and procedural schedule agreed upon during the May 7, 2002 meeting. On that same day, the County filed a letter requesting that two additional issues that were not stipulated to by the parties during the May 7, 2002 meeting be included in the procedural order for the instant docket.

On May 22, 2002, a public hearing was held on the Application in this docket at the Kauai War Memorial Convention Hall, 4191 Hardy Street, Lihue, Kauai, from approximately 4:30 p.m. to 10:15 p.m. Several hundred Kauai residents attended the public hearing. A substantial majority of those who testified expressed strong support for KIUC's acquisition of KE, including representatives of major electric service customers and various business association representatives who spoke on behalf of their member organizations.

On May 31, 2002, the commission issued Procedural Order No. 19397 (Procedural Order) setting forth the

procedures, issues, and schedule governing the instant docket.⁷ The commission used the following issues in the instant docket, as established in the Procedural Order, to determine KIUC's fitness, willingness, and ability to provide electric service on the Island of Kauai, as well as to determine whether the proposed transaction is reasonable and in the public interest:

1. Whether the Amended and Restated Purchase and Sale Agreement (Kauai Electric) filed in this docket between KE and KIUC should be approved.
2. Whether the assignment of KE's franchise to KIUC should be approved pursuant to HRS § 269-19.
3. Whether the sale of all of the "KE Assets," as that term is defined in the application filed in this docket, from KE to KIUC should be approved pursuant to HRS § 269-19.
4. Whether the financing KIUC is proposing to obtain for the purpose of acquiring the "KE Assets" should be approved pursuant to HRS § 269-17.
5. Whether KIUC is fit, willing, and able to perform the services currently offered by the utility to be acquired.
6. Whether KIUC's acquisition of the KE Assets is reasonable and in the public interest.
7. Whether it is reasonable for KIUC to use the current KE rates, tariffs, and rules and regulations for its financial projections in this docket.
8. Whether any other relief as may be just and reasonable should be granted under the circumstances.
9. Whether any other conditions or provisions are required to ensure that the proposed transaction is in the public interest.

⁷In the Procedural Order, the commission declined to adopt the two additional issues requested by the County in its letter, dated May 15, 2002.

In addition to the information requests discussed above, the Consumer Advocate filed three additional sets of information requests on May 10, 2002, May 29, 2002, and June 17, 2002, and Applicants filed their responses to these requests on May 22, 2002, June 7, 2002, and June 25, 2002, respectively, with supplemental responses filed on July 15, 2002, September 9, 2002, and September 10, 2002. The DoN filed information requests on May 8, 2002 and Applicants filed their responses to these requests on May 20, 2002. The County filed three sets of information requests on May 15, 2002, June 5, 2002, and June 24, 2002, and Applicants filed their responses to these requests on May 29, 2002, June 19, 2002, and July 5, 2002, respectively.

On July 18, 2002, the Applicants, the Consumer Advocate, and the DoN (collectively referred to as the Parties to the Stipulation) filed a Stipulation in Lieu of Preliminary Position Statements (Stipulation) recommending the commission's approval of the Application based on their global resolution of issues in accordance with the terms of the Stipulation. The County, which declined to join in the Stipulation, filed its Preliminary Statement of Position on July 19, 2002, urging the commission to reject the Application.

Based upon the representations made in the Stipulation regarding the need for final approval by September 17, 2002 in order to have RUS municipal rate fund financing for the transaction, by Order No. 19496, filed on July 31, 2002, the commission granted preliminary approval of the Stipulation, "subject to final commission review of all pleadings and

information submitted in this docket, issues raised by the County's position statement, and the conditions set forth below ... to ensure that the public interest is protected." In addition, based upon the representations made in the Stipulation regarding the RUS-imposed deadline to secure proposed RUS financing for KIUC's acquisition of KE, the commission established September 17, 2002 as the target date for the final decision and order in this docket. The commission further modified the Procedural Order to accommodate the timely issuance of its final decision and order by requiring additional discovery to be completed by August 30, 2002 instead of September 3, 2002, and the submission of the parties' final Statements of Position by September 10, 2002 instead of September 12, 2002.

The commission issued its information requests to Applicants on August 5, 2002, August 9, 2002, August 12, 2002, August 14, 2002, August 15, 2002, August 23, 2002, and August 29, 2002, and Applicants filed their responses to these requests on August 9, 2002, August 14, 2002, August 19, 2002, August 21, 2002, August 22, 2002, August 28, 2002, and September 4, 2002, respectively, with supplemental responses filed on September 9, 2002.

The Consumer Advocate and Applicants each filed their first set of supplemental information requests to the County on August 2, 2002. The County submitted partial and incomplete responses to the supplemental information requests on August 19, 2002, and certain late-filed responses on August 22, 2002. The County filed its first set of supplemental information

requests to the Consumer Advocate, the DoN, and Applicants on August 2, 2002. The respective parties filed responses to these supplemental requests on August 19, 2002. On August 19, 2002, the Consumer Advocate requested a change in the procedural schedule whereby the second set of information requests would be due on August 23, 2002, instead of the August 26, 2002 date set forth in the Procedural Order. On August 21, 2002, the commission filed Order No. 19530 approving the Consumer Advocate's request to amend the procedural schedule set forth in the Procedural Order. On August 23, 2002, the County filed its second set of supplemental information requests to Applicants and the Consumer Advocate, and Applicants each filed their second set of information requests to the County. The respective parties filed their responses to these requests on August 30, 2002.

On September 10, 2002, the parties filed their respective Statements of Position with the commission.⁸

In its Statement of Position, the Consumer Advocate recommends that the commission approve the Application, subject to the terms and conditions of the Stipulation.

The DoN, in its joint Statement of Position filed with the Applicants, also recommends that the commission approve the Application, subject to the terms and conditions of the Stipulation.

The County states in its Statement of Position that the Application "becomes acceptable for approval" only when the

⁸The Consumer Advocate and the County each filed their own Statements of Position. The DoN filed a joint Statement of Position with the Applicants.

substance of the County's five provisos are adopted by the commission.

IV. The Transaction

A. Purchase Terms

Under the Amended Agreement, and upon satisfaction of the certain conditions, including approval by the commission, KE will convey to KIUC its franchise and electric utility properties on Kauai, defined as the "Assets" in the Amended Agreement. KIUC will assume, with certain exceptions, the electric utility properties, rights, obligations, and related public service obligations of KE.

The \$215 million purchase price (purchase price) is subject to adjustment for those capital expenditures required by Citizens to comply with its tariff or as mandated by a governmental body and relate to a capital project not included in KE's approved 2002 capital budget. Applicants state that currently no such expenditures are anticipated that will result in an increase to the purchase price.

B. Financing

In the Application, KIUC requests approval for the financing of the entire purchase price by either the National Rural Utilities Cooperative Finance Corporation (CFC) or from Rural Utilities Service (RUS) and CFC together. However, in the Stipulation, the Parties to the Stipulation stated that the second financing scenario was the preferred method of financing

by KIUC, and recommended that the commission grant KIUC use of the second form of financing, pursuant to HRS § 269-17 and the terms of the Stipulation.

Under the recommended form of financing, RUS will finance the \$215 million purchase price. Additionally, CFC will provide KIUC with a \$25 million secured line of credit⁹, which shall be used for working capital purposes after KIUC acquires the KE Assets, as well as a \$60 million secured line of credit¹⁰, which shall be used by KIUC in the event of a natural disaster. The \$25 million line of credit includes approximately \$2.5 million for pre-acquisition expenses, closing costs and other costs relating to the transaction.¹¹

KIUC applied for financing from RUS for the purchase price through RUS' municipal rate loan program, which has the lowest interest rates of the available lending programs administered by RUS. Since the filing of the Application, RUS informed KIUC that its application is complete with the exception of obtaining the commission's approval. However, even though RUS reserved for KIUC the \$215 million purchase price from the municipal rate loan program, it can only be reserved until September 30, 2002, the end of RUS' current fiscal year.

⁹CFC Secured Line of Credit No. R-5102

¹⁰CFC Secured Line of Credit No. R-5103

¹¹KIUC represented in the Stipulation that it is "not projected to require borrowing from this line of credit, with the exception of the amount that will be utilized for pre-acquisition expenses, closing costs, and other costs related to the transaction." Stipulation at 17.

C. KIUC Organization

1. Membership and Allocations

Any person or legal entity that agrees to receive, uses, or purchases electricity from KIUC is eligible for membership in the cooperative. All persons currently receiving electric service from KE automatically will become members when KIUC first delivers electricity to them. KIUC will waive such membership fees for these members. Otherwise, a person may become a member only after entering into a membership agreement and paying the then current membership fee. Currently, the membership fee is set at \$10.¹²

Any customer may elect not to become a member of KIUC without loss of electrical service or discrimination with respect to rates by providing written notice to KIUC of such election. Additionally, KIUC may expel a member or terminate a person's membership for certain reasons, upon a majority vote of the board of directors. Non-members may receive electricity only upon the execution of a written contract to purchase electricity from the cooperative.

Under the terms of the Third Revised and Restated Bylaws of KIUC (Bylaws), which governs the cooperative, KIUC will establish and maintain a patronage capital account for each member. On or before April 30 of each year commencing in 2004, KIUC shall prepare and submit to RUS a calculation of its

¹²The Bylaws require that the membership fee shall not exceed \$100.

achieved operating margin dollars for the prior reporting period.¹³ Based upon this calculation, KIUC shall propose and strongly recommend RUS approval for payment of patronage capital cash refunds to its members in a total amount equal to 25 per cent of such reported prior period margin amounts.¹⁴ Upon RUS approval of the proposed patronage capital cash refunds, payments are to be made by check to KIUC members as soon as practical thereafter, but not later than 30 days from the receipt of RUS approval of that year. This provision for specified patronage capital refunds will continue until modified by commission decision and order in any future rate case proceeding. KIUC represents that net margins will be allocated to each member in the proportion that the revenue received from each member bears to the cooperative's total revenues.¹⁵

¹³For calendar year 2003, this calculation shall also include any previously unreported periods within 2002 when KIUC owned the utility. In subsequent years, this calculation will be based upon the previous calendar year, as reported in Annual Form 7 filings with the RUS.

¹⁴This patronage capital distribution system, which was agreed to by the Parties to the Stipulation, and which the County now recommends that the commission adopts as a condition of approval, varies significantly from that set out in the Bylaws.

¹⁵Net margins or net profit are defined in the Bylaws as: (1) gross receipts (on a fiscal year basis); less (2) operating expenses and costs, the cost of services performed for members, the cost of products, supplies and other property procured or sold by KIUC, all taxes and other necessary expenses, reasonable reserves for depreciation, depletion, obsolescence of physical property, doubtful accounts, and other valuation reserves.

2. Board of Directors

KIUC's interim board of directors (board) is currently comprised of a group of volunteers. Within 120 days of the completion of the acquisition, the members of KIUC will elect a permanent governance board consisting of not less than seven and not more than nine voting directors to replace the interim board. The president of the cooperative shall be a non-voting, ex-officio member of the board. Management and operation of the utility will be the responsibility of the management team employed by KIUC.

V. Standard of Review

HRS § 269-19 gives the commission broad discretionary authority to review Citizens' sale of KE's assets and the transfer of KE's franchise to KIUC. In addition, HRS § 269-7(a) gives the commission the power to examine, among other things, the condition of a public utility, the manner in which it is operated with reference to the safety or accommodation of the public, the utility's business relations with other persons, companies, or corporations, and all matters affecting the relations and transactions between the utility and the public or persons or corporations. Thus, the commission has authority to examine all transactions that affect or may affect the public served by the utility.

Since HRS § 269-19 does not contain specific criteria or standards for the commission to consider in the transfer or assignment of a franchise, the commission historically, in its

review of applications for the sale of public utility assets and the transfers of certificates of public convenience and necessity (CPCN) and franchises, pursuant to HRS § 269-19, has utilized the same standards of review found at HRS § 269-7.5 for guidance, to wit, that the applicant is "fit, willing, and able properly to perform the service proposed."¹⁶ The use of these standards of review, therefore, does not require that the commission also undertake, among other things, an initial rate review, as set forth under HRS § 269-7.5.

Therefore, before the commission approves any acquisition of a public utility subject to the commission's jurisdiction under HRS § 269-19, we must find that (1) the acquiring utility is fit, willing, and able to perform the service currently offered by the utility to be acquired, and (2) the acquisition is reasonable and in the public interest.

HRS § 269-17 requires a public utility to obtain the commission's approval before issuing stocks and stock certificates, bonds, notes, and other evidences of indebtedness payable at periods of more than 12 months after the date of issuance. The statute limits the purpose for which stocks and other evidences of indebtedness may be issued to, among other things, the acquisition of property, building or construction, or improving the utility's capital facilities or services.

¹⁶See Decision and Order No. 17377, filed on November 17, 1999, in Docket No. 98-0345, and Decision and Order No. 15899, filed on September 10, 1997, in Docket No. 97-0035.

A. Fitness, Willingness, and Ability to Perform the Services

The Consumer Advocate states in its Statement of Position that KIUC's financial fitness is demonstrated by the projected coverage ratios, equity buildup, and free cash flow balances that will be achieved over a ten-year timeframe based upon KE's current rates and on RUS municipal loan financing. According to projections provided to the parties and the commission, KIUC's equity is expected to increase to approximately \$73.2 million after projected patronage capital credit refunds pursuant to the terms of the Stipulation. In addition, free cash flow is expected to accumulate to approximately \$86.6 million over the same ten-year timeframe. The Consumer Advocate, the DoN, and the Applicants contend that the rapid equity build-up with the RUS municipal rate financing enables KIUC to propose the acceleration of patronage capital refunds provided for in the Stipulation. Moreover, the Consumer Advocate asserts that the assumptions and methodologies employed in the projections submitted in this docket appear to introduce conservatism into the estimates.

Applicants contend that KIUC's financial fitness is further enhanced by the proposed \$25 million secured line of credit from CFC for working capital, and the separate \$60 million secured line of credit from CFC for emergency purposes in the event of a natural disaster.

The parties to the Stipulation state that KIUC's willingness to own and operate Kauai's electric utility is evident from the amount of time and energy it has dedicated to

this goal, not only in its initial attempts to purchase the KE Assets pursuant to the Original Application, but also in its extensive negotiations with Citizens to amend the Original Agreement and file this Application to address, among other things, the concerns previously raised by the commission and the Consumer Advocate, the County, and the DoN in Docket No. 00-0108. These efforts include organizing a group of residents committed to the purchase of the KE Assets, hiring numerous experts and consultants, obtaining financing commitments for the purchase of the KE Assets, and conducting numerous field audits and investigations. The Parties to the Stipulation suggest that these efforts clearly demonstrate KIUC's willingness to assume the responsibility of owning the KE Assets and operating Kauai's electric utility.

The Consumer Advocate states that in addition to having the necessary financial resources to fund the utility operations, there are three additional factors that should be considered in determining KIUC's ability to provide service to KE customers. First, KIUC must secure the technical expertise to operate and maintain the plant facilities and ensure the provision of reliable service. Second, KIUC must be able to successfully transition the change in support systems and service providers for those services previously received from Citizens. Third, KIUC must have the necessary plant facilities to produce and deliver the electricity to KE's customers.

In the instant docket, KIUC took many steps to assure secure service continuity to KE customers. KIUC agreed to offer

employment to all active KE employees in the same and substantially equivalent positions, and at the same compensation level (including wages, salaries, and bonuses). In addition, KIUC offered continued employment to all members of KE's management team and entered into employment agreements with all members of KE's management team for continued employment upon KIUC's purchase of the KE Assets.

Applicants stated that they are involved in a transition planning process to assure a smooth transition from Citizens' ownership of KE's assets to KIUC ownership, as well as to assure KIUC's ability to perform the service of supplying and distributing electricity on the Island of Kauai without adversely affecting the quality of service provided to KE's current customers.

In addition, KIUC states that it will become a member of the National Rural Electric Cooperative Association (NRECA), a large nation-wide cooperative support network. Through its membership in NRECA, KIUC contends that it will be able to tap into the resources of other utility cooperatives to further assist KIUC in the ability to continue to provide high quality electrical service on Kauai, especially in the event of a disaster.

Based upon our review of the record and the representations of the parties, we find that the KIUC is fit, willing, and able to provide electric service to KE's ratepayers on the Island of Kauai.

B. Reasonableness and in the Public Interest

Applicants, the Consumer Advocate, and the DoN assert, in their respective Statements of Position that: (1) the Amended Agreement, as modified by the Stipulation, (2) the use of KE's current rates, tariffs, rules and regulations, (3) the acquisition of the KE Assets by KIUC, and (4) the transfer of KE's franchise to KIUC are reasonable and in the public interest for the following reasons:

- (a) The purchase price is fair and reasonable and is well supported by the arms-length negotiations between Applicants, and the fairness opinion prepared by a noted financial advisor;
- (b) KIUC has no intention to seek a rate increase now or in the foreseeable future as a result of the purchase of the KE Assets;
- (c) KIUC agreed that on or before April 30 of each year commencing in 2004, it shall propose and strongly recommend RUS approval for the payment of patronage capital refunds to its members in a total amount equal to 25 per cent of the previous year's margin amount, and Citizens agreed to provide one-time payments to KE's customers in the total amount of \$3 million within one year from the date of closing of KIUC's purchase of the KE Assets;
- (d) KIUC will be able to call upon NRECA for support in times of disaster, and will be eligible to

apply for FEMA grants/reimbursements for up to 75 per cent of the cost of recovery;

- (e) Members of KIUC will be entitled to: (1) receive patronage capital refunds, (2) participate in the determination of policies, goals, and objectives of the utility, and (3) enjoy the benefit of local ownership;
- (f) KIUC will benefit from income tax exemption and financial savings produced by recapitalization of the business with low-cost RUS debt, which should result in lower revenue requirements; and
- (g) KE's current rates are just and reasonable, and the use of existing rates by KIUC is consistent with past commission decisions and orders.

After careful consideration and review of the record and the parties' representations we find that: (1) the Amended Agreement, as amended by the Stipulation, (2) KIUC's use of KE's current rates, tariffs, and rules and regulations for its financial projections in this docket, (3) KIUC's Acquisition of KE's assets, and (4) the transfer of KE's franchise to KIUC are reasonable and in the public interest.

C. Financing is for a Permissible Purpose

Under the terms of the Stipulation, the acquisition of KE's assets is to be financed by RUS through a \$215 million municipal rate loan, while CFC secured lines of credit will remain available for any working capital or disaster recovery

requirements. The Consumer Advocate notes that, with the exception of the funds to be used for working capital and disaster recovery purposes, the funds obtained through the financing proposal meet the requirements of HRS § 269-17. However, it further states that in the instant docket, it also supports the request to secure line of credit financing for unanticipated working capital needs and disaster recovery.

Upon a review of the record and in light of the differing form of cooperative ownership that is proposed, the commission finds that the financing requested by KIUC is for permissible purposes and should be approved.

VI. Observations

As guidance to the permanent governance board of KIUC, the commission offers the following observations and recommendations:

- A. Upon a review of KIUC's Bylaws and HRS § 414D, which is applicable to KIUC by virtue of HRS § 421C-3(b), it appears that a potential exists for board members to have financial conflicts of interest with KIUC, which may color the board member's actions in his or her capacity as a board member. The commission recommends that KIUC review its conflicts of interest policies set forth in its various resolutions and Bylaws, and expressly prohibit such financial conflicts of interest by board members.
- B. The commission notes that the KIUC minutes contained in the record provided the commission with little substance for its review and deliberations. The commission recommends that greater detail and effort be put forth in the future presentation of minutes to provide a fuller and more accurate record of meetings.

- C. The commission notes that KIUC recently passed three resolutions, which among other things, allowed for all meetings of the members and all meetings of the board, except for those defined as "Executive Meetings,"¹⁷ to be open to the public. The commission supports these resolutions and finds that KIUC's amendments to include the public are appropriate.
- D. The commission acknowledges that current KE customers upon becoming KIUC members, may be confused as to if, when, and how much patronage capital will be refunded to them, and suggests that KIUC undertake efforts to provide its members with adequate, objective information that clarifies the amount and timing of any such patronage refunds that may occur.

Additionally, the commission recommends that KIUC provide its members with other educational programs aimed at providing the members with fundamental information relating to how a cooperative works and the rights and obligations of cooperative members.

- E. The commission believes that while the Applicants, in their attempt to secure favorable RUS municipal rate financing, were working within tight time constraints, they still had sufficient opportunity to conduct public education programs, solicit members, and nominate and elect permanent governance board members.

Accordingly, the commission recommends that KIUC obtain its permanent governance board within 120 days of this decision and order. It further notes that it would have been the commission's preference that KIUC have its membership and permanent governance board in place prior to the filing of the Application, or at least prior to the financial closing of KIUC's acquisition of KE's assets.

In addition, the commission recommends that an independent elections monitor supervise the board elections to ensure that the members have a high level of confidence in the election results.

¹⁷Executive Meetings are defined and appear to relate to the following matters: human resource, legal consultation, safety and security of KIUC, and proprietary or financial nature.

1. Moreover, the commission believes that Applicants should have provided it with a more accurate timetable at the time of the filing of the Application, which included the September 30, 2002 fiscal year deadline for RUS financing, rather than raising the critical dates more than five months later.
- F. As to the \$3 million to be paid by Citizens to the KE customers pursuant to the terms of the Stipulation, the commission states that its preference would be for Citizens to pay the funds into an escrow or similar account at the time of financial closing and distribute to members as soon as possible thereafter.
- G. The commission again notes that the patronage capital distribution system varies significantly from that set out in the Bylaws. This system, however, was agreed to by the Parties to the Stipulation and by the County, which now recommends that the commission adopt the conditions of the Stipulation as a condition of this approval.
- H. The record contained four differing forecasts of peak loads for KE. While different, the forecasts all indicate that there may be a need to establish additional capacity at sometime in the near future in order to maintain service quality. The commission recommends that KIUC examine its peak load forecasts and any impact that the potential need for increased capacity may have on its capital spending programs.

VII. Other Relief, Conditions or Provision
to Ensure the Public Interest

As previously stated, the commission finds that KIUC is fit, willing, and able to perform the services currently offered by the utility to be acquired. It further finds that: (1) the Amended Agreement, as modified by the Stipulation, (2) the use of KE's current rates, tariffs, and rules and regulations by KIUC, (3) the acquisition by KIUC of KE's assets, (4) and the transfer of KE's franchise to KIUC are reasonable and in the public

interest. In addition, the commission finds that the financing that KIUC will obtain is for a permissible purpose. Accordingly, the commission also concludes that the terms and conditions of the Stipulation should be approved in its entirety.

The commission observes that since the County recommended in its final Statement of Position that the conditions of the Stipulation should be approved, all parties to this docket now concur that the conditions included in the Stipulation should be adopted in this docket.

In addition, in its final Statement of Position, the County recommends that the commission adopt five conditions in the commission's approval of the Application and Stipulation. A summary of these conditions is as follows:

1. Within five days of the approval of the Application, KIUC shall request the approval by the commission of a set of tariffs identical in substance and form to the tariffs of KE, except that each and every rate, fee, and charge (except the energy recovery adjustment clause provisions) shall be reduced by six per cent.
2. Financial closing shall be accompanied by an escrow or like account with Citizens' instructions to escrow directing that a portion of the proceeds of the sale be available to be utilized as a potential source to fund annual payments for a period of time, to assist KIUC with adversities other than those attributable to natural catastrophes.
3. As a condition precedent to the financial closing of the Amended Agreement, KIUC's board shall, among other requirements, amend the Bylaws to, among other things, provide that members and ratepayers may attend all board meetings and eliminate the board education or expertise requirements.
4. The purchase price shall be funded with monies provided by RUS at interest rates substantially

similar to the weighted average interest rate for municipal rate funds for the third quarter of 2002.

5. The commission adopts the conditions of the Stipulation.

With the exception of the County's condition number five, the commission declines to adopt the conditions recommended by the County. The commission finds the County's conditions numbered one and two, to be unsupported by the record in this docket. The first instance when the County introduced the suggestion for a six per cent rate reduction and an escrow requirement was in its final Statement of Position filed on September 10, 2002. Therefore, the commission must decline to approve such recommendation, and finds, among other things, that the six per cent rate reduction figure is arbitrary and unsupported by the record in this docket. Similarly, the commission finds that the recommendation for an escrow arrangement as discussed in the County's final Statement of Position, among other things, is unsupported by the record in this docket.

The commission declines to adopt the County's condition number three, because, among other things, the commission desires to defer to KIUC's board for matters of cooperative governance.

Moreover, the commission declines to adopt the County's condition number four. The commission recognizes that the County requested the condition with the intent that the commission compel KIUC to obtain the most favorable RUS municipal rate available. However, the commission recently learned that the use

of the RUS third quarter municipal loan rate will result in the imposition of a higher rate upon KIUC. The Applicants and the DoN in their joint final Statement of Position¹⁸ indicate that the fourth quarter weighted average interest rate for KIUC's proposed RUS municipal rate financing is 4.131 per cent, a rate that is lower and more favorable than the third quarter rate of 4.531 per cent. As a result, the commission finds that the more favorable, fourth quarter rate should be obtained by KIUC.

VIII.

THE COMMISSION ORDERS:

1. That the Amended Agreement, as modified by the Stipulation, is approved, subject to the applicable terms and conditions outlined in the Stipulation and set forth herein, pursuant to HRS § 269-19.

2. The assignment of KE's legislatively-granted franchise to KIUC is approved, subject to the applicable terms and conditions outlined in the Stipulation and set forth herein, pursuant to HRS § 269-19.

3. The sale of certain of KE's assets to KIUC is approved, subject to the applicable terms and conditions outlined in the Stipulation and set forth herein, pursuant to HRS § 269-19.

4. The financing to be obtained by KIUC for the purpose of acquiring KE's assets, which consists of funding the

¹⁸Final Position Statement of Citizens, KIUC and the DoN at 18.

\$215 million purchase price with RUS municipal rate loan financing, as well as the \$25 million secured line of credit and the \$60 million disaster recovery line of credit from CFC is approved, pursuant to HRS § 269-17, subject to the condition that the \$215 million purchase price is financed by RUS at closing at a weighted average interest rate that is substantially similar to the weighted average interest rate for municipal rate funds for the fourth quarter of 2002 contained in Appendix A to the Final Position Statement of Citizens, KIUC, and DoN, filed on September 10, 2002.

5. KIUC's use of KE's current rates, tariffs, and rules and regulations for its financial projections in this docket is approved, subject to the applicable terms and conditions outlined in the Stipulation and set forth herein.

6. The Applicants shall promptly provide the commission with written notice of the approval of RUS municipal rate financing and of the financial closing of the transaction contemplated in this docket.

7. KIUC shall continue to provide the commission and the Consumer Advocate with any and all reports that are currently filed by KE with the commission and the Consumer Advocate.

8. The Stipulation is approved in its entirety, including, without limitations, the following conditions derived from said Stipulation:

- a. In the event the commission issues its final Decision and Order in this docket on or before September 17, 2002 approving the relief described herein, Citizens shall refund to customers of KE no later than the

first(1st) anniversary of the closing of the sale to KIUC, the sum of \$3 million dollars. Refunds shall be fully funded by Citizens at no expense to KIUC and shall be made by regular mailing of checks to all KE customers of record at the date of closing, with refunds distributed ratably based upon total billed revenues to each customer for electric service during the preceding twelve (12) month period. KIUC shall act as paying agent for Citizens in making such refunds, using segregating accounting and bank accounts for such purposes. For any delinquent individual customer accounts as of the refund payment date, KIUC shall offset refunds due that customer as an account credit to mitigate KIUC exposure to uncollectible accounts. A report shall be prepared and submitted by KIUC on or before January 31, 2004 to the commission and the parties to this docket reconciling the total amount of checks mailed, delinquent account offsets, checks returned non-deliverable and amounts otherwise not cleared through KIUC bank accounts, with any residual unpaid amounts retained by KIUC to offset the costs of refund distributions.

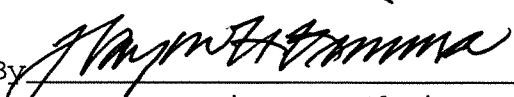
- b. On or before April 30 of each year commencing in 2004, KIUC shall prepare and submit to RUS a calculation of its achieved operating margin dollars for the prior reporting period. Based upon this calculation, KIUC shall propose and strongly recommend RUS approval for payment of patronage capital cash refunds to its members in a total amount equal to twenty-five per cent (25%) of such reported prior period margin amounts. Upon RUS approval of the proposed patronage capital cash refunds, payments are to be made by check to KIUC members as soon as practical thereafter, but not later than thirty (30) days from receipt of RUS approval of that year. This provision for specified patronage capital refunds will continue until modified by commission Decision and Order in any future rate case proceeding. Complete copies of all calculations and correspondence associated with administration of this provision shall be timely submitted for review by the commission and the Consumer Advocate.

- c. KIUC will prepare and file with the commission and the Consumer Advocate a fully documented depreciation accrual rate study on or before July 1, 2004. This study is to be reviewed by the Consumer Advocate in accordance with a mutually agreeable procedural schedule, subject to commission approval, and shall be available for consideration and possible implementation or modifications in any future KIUC rate change proceedings.
- d. Applicants acknowledge the commission's policy to not allow recovery from utility customers of goodwill or acquisition premium amounts arising from utility merger and acquisition transactions. In accordance with this policy, KIUC will not seek rate recovery of any goodwill amortization, acquisition premium costs or goodwill impairment changes pursuant to Generally Accepted Accounting Principles in future rate proceedings.
- e. Pursuant to the Stipulation, Applicants, the Consumer Advocate and DoN acknowledge that debt service on acquisition indebtedness will not be disallowed.
- f. Applicants acknowledge the commission's policy to not allow accounting deferral or recovery from utility customers of transaction and transition costs arising from utility merger and acquisition transactions. In accordance with this policy, KIUC will not seek rate recovery of any transaction or transition costs or amortization of such costs in future rate proceedings.
- g. Pursuant to the Stipulation, Applicants, the Consumer Advocate and DoN acknowledge that debt service on transaction and transition costs will not be disallowed.
- h. KIUC will prepare and submit for commission and Consumer Advocate review and consideration its proposed revisions to Integrated Resource Plan and Demand Side Management programs on or before December 31, 2003. Citizens and KIUC waive all claims they may have to recover earned but unbilled demand side management shareholder incentives from KE customers.

- i. KIUC will promptly notify the commission and the Consumer Advocate of any significant investment of KIUC financial capital, KIUC labor, or other KIUC resources into any new or planned business operations other than the retail generation and delivery of electricity and activities directly supportive of the electric utility business. This notification shall include a detailed statement of business plans, resource amounts involved, anticipated risks and opportunities and the anticipated financial impact upon KIUC over the next five (5) years.
- j. KIUC agrees to cooperate with the Consumer Advocate in the development of appropriate and cost effective financial information formats, media, and plans for dissemination of such information to KIUC members. Included in these information disclosures will be regular periodic publication of KIUC's related party relationship and transaction policies, as well as disclosure of the dollar amounts by payee of specific, individually material transactions totaling in excess of \$10,000 with any individual related party (other than KIUC payroll information) within the prior reporting period.
- k. Within one hundred eighty (180) days of closing, KIUC is to review and submit the Kauai Electric Emergency Preparedness and Recovery Plan, as appropriate, to recognize KIUC ownership and operations.

DONE at Honolulu, Hawaii this 17th day of September,
2002.

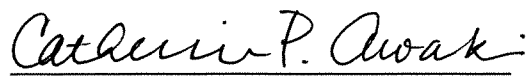
PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Wayne H. Kimura, Chairman

By 
Janet E. Kawelo, Commissioner

By (RECUSED)
Gregg J. Kinkley, Commissioner

APPROVED AS TO FORM:


Catherine P. Awakuni
Commission Counsel

02-0060.eh

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 19658 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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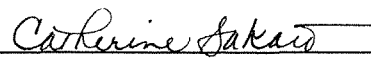
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Catherine Sakato

DATED: September 17, 2002